

**COORDINATED ISSUE
SECURITIES & FINANCIAL SERVICES INDUSTRY
TAXABLE YEAR OF INCLUSION OF
STOCK BROKER'S COMMISSION INCOME**

ISSUE:

Whether under I.R.C. Section 451, stock brokerage houses, using the accrual method of accounting, must accrue commission income on the sale or purchase of securities on the "trade date" as opposed to the "settlement date."

Facts

The taxpayer is a stock brokerage house, using the accrual method of accounting, engaged in the securities business as a member of the New York Stock Exchange. The taxpayer, at the request of the investor, enters into contracts to buy and sell securities. The date on which these contracts are entered into is termed the "trade date." At this time, a confirmation statement itemizing the transaction and listing the price of the securities, the quantity and the amount of commission due, is sent to the investor. Then, pursuant to the rules of the New York Stock Exchange requiring the settlement of customer accounts no later than five business days after trade date, delivery of and payment for the securities is generally made on the fifth subsequent business day, which is termed the "settlement date." During the period between trade date and settlement date, the taxpayer performs administrative services necessary to effectuate the physical exchange of the securities and payment on the settlement date. The brokerage commission is based upon the sale or purchase of securities, as established on the trade date.

LAW:

Application of Section 451

Section 451 of the Code provides that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-1 of the regulations provides that under the accrual method of accounting, income is includable in gross income when all the events have occurred that fix the right to receive the income and the amount thereof can be determined with reasonable accuracy.

Under the facts of the present situation, the amount of the compensation (commission) is determined by reference to the sale and purchase of the security. The amount of income to be received by the taxpayer can be determined with reasonable accuracy on the trade date because that is the date the price is fixed. The right to receipt of compensation is fixed on the trade date because that is the date that the purchase (or sale) of the security occurs.

In *Georgia School-Book Depository, Inc.*, 1 T.C. 463 (1943), the (broker) entered into a contract with book publishers whereby he was to perform various services in executing and consummating the sale of textbooks to the state of Georgia. The broker had performed most of the services, except collection of payments from the state and transmission of the balance (after reduction for the broker's commission) to the publishers. The court stated at page 468 that the services of receiving the money from the state and transmitting it to the publishers were "the least of its duties and cannot be made the criterion of the arising [sic] of the right [to commissions]." Therefore, it held that the right to income accrued upon the performance of the other services required under the contract. Although it can be argued that the broker in that case merely had to await payment by the state of Georgia, the fact remains that the contract between the broker and the publisher required the broker to perform the services of collection from the state and transmission to the publishers of amounts due from the book sales. We believe that this case recognizes that an accrual of income based upon the performance of services can be required at a point in time when the primary services have been performed, even though other incidental services must be rendered in the future.

Commission income is accruable on the trade date, rather than the settlement date. Looking at the entire transaction, the service that the broker is to perform is the execution of a purchase (or sale) of securities. The execution takes place on the trade date, when a valid, binding contract for purchase or sale (a trade) is entered into by the broker as agent for the investor (principal). Any remaining services are performed only to complete the mechanics of the physical transfer of the stock on the settlement date. The process of sorting out the trade and forwarding a list of securities traded to the securities clearing corporation are ministerial actions in confirmation of the actual trade executed on the trade date, not actions that are necessary to fix the broker's right to receive the commissions.

Revenue Ruling 74-372

Revenue Ruling 74-372 holds that a stock brokerage business using the accrual method of accounting must accrue the commission income on the sale or purchase of securities for a customer on the trade date rather than the settlement date. In addition,

a change to the method of accruing commission income on the trade date is a change in method of accounting under sections 446 and 481 of the Code.

Revenue Procedure 92-20

As stated above, switching from accruing commission income on the settlement date to accruing it on the trade date is a change in accounting method. Therefore, before implementing the change, a taxpayer must secure the consent of the Commissioner as required under section 446(e) of the Code and section 1.446-1(e) of the regulations. A taxpayer that applies for consent on or after March 23, 1992, must satisfy the terms and conditions in Rev. Proc. 92-20, 1992-1 C.B. 685. These terms and conditions vary depending on whether the method to be changed is classified as a Category A, Designated A, Category B, or Designated B method. Sections 3.06 - 3.09. At present, accruing commission income on the settlement date is a Category B method.

CONCLUSION

As stated in Rev. Rul. 74-372 all the events have occurred that fix the taxpayer's right to receive the commission on the trade date. All actions that remain to be performed by the taxpayer after this date are of a ministerial nature. Also, since the amount of commissions is determined on the basis of the securities sold or purchased on the trade date, the amount of income to be accrued can be determined with reasonable accuracy. Accordingly, it is held that, the proper time for accruing the commission income on the sale or purchase of securities is the trade date.

Any change to the method of accruing commission income on the trade date is a change in method of accounting within the meaning of section 446 and 481 of the Code and the regulations thereunder.